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Address by the Governor on the presentation of the book *A macroeconomic view of the forty years of the Spanish Constitution*, by José Luis Malo de Molina

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Honourable Minister of the Economy and Authorities, ladies and gentlemen.

Let me begin my opening address by thanking you for inviting me to the presentation of José Luis Malo de Molina's work *A macroeconomic view of the forty years of the Spanish Constitution*.

My gratitude is twofold. First, I would like to publicly express my recognition of José Luis's dedication to the Banco de España. There, as you know, he led the Research Department for almost twenty-five years, bequeathing a legacy of independence and rigour which those of us following him are striving to maintain and, as far as possible, build on. And further, I wish to praise the Ministry's initiative to promote a work reviewing Spain's economic performance over the constitutional period. I believe that what we have is a necessary text that highlights the importance the principles enshrined in the Constitution have had for improving citizens' well-being and for Spain's economic growth. In parallel, the book also sets out the major challenges still ahead.

Economic growth during the democratic era

There is no question about the book's timeliness. The fact the Spanish Constitution has been in place for 40 years now is an excellent reason for looking back and taking stock of the far-reaching changes in our economy during these four decades of democratic maturity.

The thesis of the work is also, in my opinion, impeccable. We cannot understand Spain's economic development in recent decades without referring to the freedom and equality framed by our constitution.

True, there have been major ups and downs, including the deepest crisis we have known in the past 80 years. But the economic assessment of the constitutional period is clearly positive. This outcome should not surprise us. Indeed, the latest economic literature stresses the positive effects of democratic institutions on economic growth. In this connection, I would urge you to read a recent paper by the economists Daron Acemoglu, Suresh Naidu, Pascual Restrepo and James Robinson, in last January's *Journal of Political Economy*¹. The authors show empirically that democracy causes economic growth in the long term and its impact is quantitatively significant: up to 20% of the country's per capita income over the long run.

¹ D. Acemoglu, S. Naidu, P. Restrepo and J. A. Robinson (2019), "Democracy does cause growth", *Journal of Political Economy*, 127(1)

The literature also identifies the channels through which democracies enable higher economic growth. These are very diverse. They range from the incentives for promoting reforms enhancing the business climate, private investment and external openness, to their positive effects on developing countries' fiscal capacity and increased spending on education, health and other public goods.

The notable economic and social transformation in Spain over these four decades testifies to the positive economic results associated with democracy. In the past 40 years our country has witnessed cumulative growth in GDP and in consumption, both expressed per capita and in purchasing power parity terms, of 86% and 63%, respectively. This growth has provided for convergence in per capita income towards the average of the core euro area countries of around 7 percentage points (pp). And on the latest available figures, it is standing at over 87% of the average income in the euro area.

Let us turn to the possible channels that have enabled this economic development. Without wishing to lay down empirical causalities, the aforementioned variables habitually indicated by the economic literature may likewise be invoked in Spain's case, regarding the role of both the private and public sectors.

First, for instance, the economy's degree of external openness. Measured via the weight of exports and imports in GDP, this has increased by almost 40 pp. Next, the stock of private productive capital (relative to employment) has more than doubled, as has the stock of residential capital (relative to the population). The degree of convergence in relation to the euro area average in this respect has also been most significant. In the case of the stock of private productive capital, the Spanish economy stood in 1980 close to the average euro area level and is today more than 10 pp above it. Meanwhile, in terms of the stock of residential capital, Spain was more than 30 pp off the average, but recent data show that this gap has narrowed by around 14 pp.

Regarding the role of the public sector, the stock of public capital assigned to citizens' well-being, essentially comprising transport, health, educational and other similar infrastructure, has quadrupled. In real per capita terms, it has risen in this period from around €3,000 to €13,500 in 2016. And, compared with the euro area, the degree of convergence in this area exceeds 55 pp. Public spending on education and on health has doubled. The percentage of the adult population with intermediate and higher studies has increased by 14 pp and 16 pp, respectively. And in terms of integration of women into the labour market, progress has been particularly significant. Since 1978, the Spanish population has increased by over 10

million, and numbers of people employed, have risen by almost 7 million, of whom over 5 million are women. That has raised the female participation rate from scarcely 28% to 53%.

The start of this period of undoubted prosperity may be said to be the Moncloa Pacts. The guiding principles of these agreements were the restructuring and reform of the Spanish economy. As a landmark in the culture of consensus that led shortly afterwards to the approval of the Constitution, the Moncloa Pacts enabled Spain to leave behind an interventionist economic system marked by galloping inflation, growing unemployment and persistent external deficits. The economy duly set out on the road to modernisation and European rapprochement.

The opening up and integration of Spain into Europe was a lengthy and costly process, and one not free from its ups and downs. But success came first, with membership of the European Economic Community in 1986; and then, in 1999, when Spain joined the euro area, subsequently adopting the euro as our currency. The single market and the euro are two major economic projects, underpinned by firm political resolve, which give expression to the European values of freedom, competition and economic and monetary stability.

In this respect, as José Luis stresses in his book, economic success in the constitutional age stems probably from democracy having: enabled our economic integration into Europe; allowed stability-oriented economic policies to be pursued; and helped in the development of our welfare state and the modernisation of our tax system.

In fact, some of our economic problems in the past four decades have arisen from not having been able to understand the obligations and constraints stemming from the interaction of these three factors. This is the case of our membership of the euro area. Being part of this common project has allowed us to import the credibility of our European partners' macroeconomic stability (apparent above all in lower interest rates), which has been conducive to economic growth since. But, on top of the shortcomings of the euro area's initial architecture, we should acknowledge that, during the first decade of the euro, not enough attention was given to the constraints that being part of a monetary union entails. I refer here, above all, to the crucial role that internal adjustments to the economy must play to prevent the build-up of macrofinancial imbalances. This is especially so in settings of easy monetary and financial conditions, such as those in place in the early years of the single currency, when it is not possible to resort to the devaluation of the currency, as frequently occurred in the past. The absence of a sufficient emphasis on the need to promote the internal adjustments our economy called for in these circumstances ultimately fuelled the accumulation of major imbalances. That meant that Spain confronted the

international financial crisis in the past decade from a very vulnerable position. Regrettably, we learned all too well the painful costs involved, in terms of the depth of the recession, the high loss of jobs and the severity of the adjustments that had to be made.

The challenges ahead for the Spanish economy

All told, the net balance of these 40 years for our economy is clearly positive. But that should not lead to complacency. And, in this respect, José Luis's book is also useful. It reminds us that the Spanish economy continues to have major challenges ahead, and that the continuity of expansion in the future and the spread of its positive effects to all citizens will largely hinge on how these challenges are faced.

Some of these challenges are the consequence of the depth of the last crisis, and others the outcome of the latest economic changes. But we can also identify a group of challenges that mirror the structural problems that have been present throughout the constitutional period and which we have not tackled with sufficient resolve.

Beginning with the latter, the progress in the labour market over the course of the democratic era has been clearly insufficient. Despite the regulatory changes made in recent decades, a structural problem of high unemployment persists. Let us not forget that the average unemployment rate in the Spanish economy during the constitutional period has been 17%, almost double that observed in the euro area countries.

A further symptom of the dysfunction of our labour market is the high rates of temporary employment, which far exceed those of the euro area economies. All these adverse features of our labour markets have significant consequences; not only in terms of efficiency and economic growth capacity, but also of household income inequality, which increased notably during the crisis as a result, especially, of strong job destruction.

Improving levels of well-being also requires that another of the main structural weaknesses of our economy be overcome. This is, namely, our modest productivity growth, which is persistently below average euro area levels.

Poor productivity dynamics are due to many factors. These include most notably shortcomings in the quality of the education and training system; the low level of technological capital (where, in terms of weight in GDP, for example, Spain is still almost 40 pp below the euro area average); high temporary employment, once again; and certain deficiencies in the quality of institutions, the degree of competition and the functioning of product and services markets, among others. In my view, there is something that could

activate productivity dynamics and which has to do with the role of the public sector in the economy: this would be to provide for the periodic and systematic evaluation of public policies, which we have proven unable to do in recent decades.

Our poor productivity performance has an evident cost in terms of wealth. A simple calculation illustrates how, if Spanish total factor productivity had mirrored that of the euro area, workers' income would today in Spain be almost 90% of the euro area average, compared with 83% at present. We should also stress that any future productivity gains associated with these reforms would pave the way for the additional gains in competitiveness our economy needs to continue running the ample external surpluses that help reduce our still-high external debt, one of our main vulnerabilities. Also, with these productivity gains, improving competitiveness would not have to be exclusively focused on the moderation of labour and financial costs, as has been the case to date in the recovery.

The economic crisis has put new challenges on the table. For instance, the public finances shortfall (in terms of deficit and public debt), which is one of the main challenges our economy still faces as a result of the legacy of the crisis. And, once more, I must underscore here the importance of upholding the culture of macroeconomic stability. This is one of the pillars of the economic development witnessed in our democratic age, and is particularly relevant in the context of our euro area membership. Among other considerations, this is because the persistence of high deficit and public debt levels restricts the fiscal policy headroom for countering possible adverse scenarios in the future.

Finally, there are other far-reaching challenges, rooted in certain trends from the past, whose effects are materialising or accelerating at present. Such is the case of population ageing. This is illustrated by the fact that the dependency ratio (defined as the ratio of the over-65s to the working-age population), which stood at around 16% at the start of the constitutional period and which is currently at 25%, will exceed 50% by mid-century. The effects of these demographic developments will be patent in many areas of the economy. They will affect consumption and saving patterns; prompt a reduction in the workforce and, possibly, in the pace of productivity; and put to the test the effectiveness of demand-side policies in stabilising activity. In this connection, I would point you to the *Annual Report 2018*, published yesterday by the Banco de España, which contains a chapter analysing these matters. It is also a given that population ageing will exert – and is already exerting – most significant pressure on specific public spending items, pensions in particular.

The scale of these challenges means that, in my opinion, it will be a priority in the particular areas involved to reach broad political agreements to tackle them promptly and resolutely.

The spirit of consensus that characterised the time at which our own *Magna Carta* was drafted serves as a good example.

Lastly, I also consider it important to accept that our membership of the European Union and, in particular, of the euro area obliges us constantly to bear this context in mind. It is, then, worth identifying not only national challenges but also European ones, on which we must work together with our partners. We no doubt share the belief that, despite the improvements made during the crisis, many weaknesses in the institutional structure of the euro area remain. And I believe the priority areas where progress is needed have been clearly identified.

Firstly, the Banking Union must be completed without delay, through the establishment of a common deposit guarantee scheme. Secondly, the Capital Markets Union project must be pushed through, with the aim of increasing the depth and integration of euro area financial markets. That would result in greater risk diversification and sharing, and in a more balanced mix between bank lending and financing from capital markets. Lastly, although the Eurogroup has decided to move ahead in designing and setting in place a fiscal instrument to support competitiveness and convergence, consensus around a cyclical stabilisation instrument has yet to be reached. Appropriately designed, such an instrument could be a powerful tool for promoting a greater degree of cross-country mutual insurance against idiosyncratic risks, and it would soften the differential impact that asymmetric shocks have on the euro area members.

Conclusion

To conclude, allow me to acknowledge once more José Luis's magnificent work at the helm of the Research Department (since re-named "Directorate General Economics, Statistics and Research"), his more recent advisory role in Spain's Permanent Representation before the European Union and, of course, his authorship of the book we are presenting today.

Thank you.